

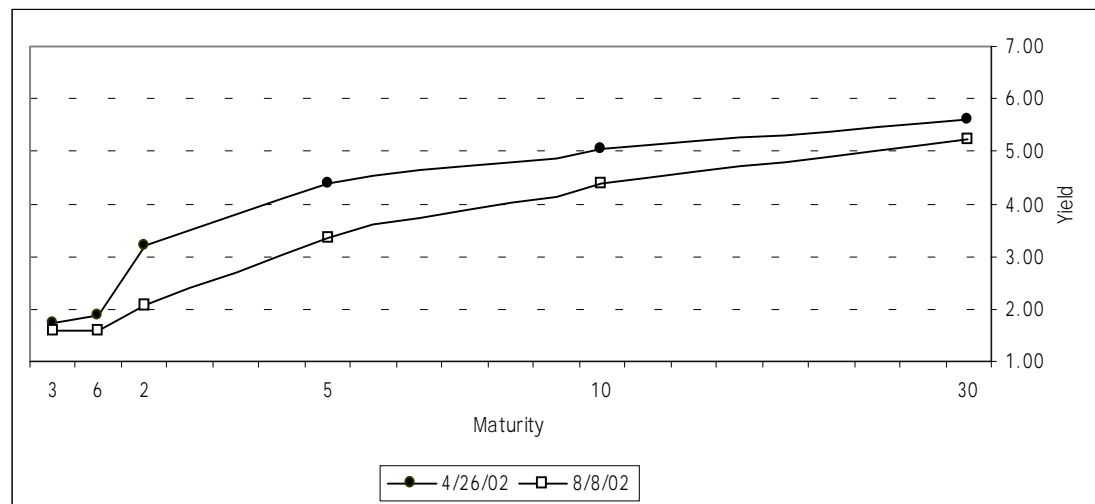
MICHAEL J. MURPHY
State Treasurer

Second Quarter 2002

The QUARTERLY

Local Government Investment Pool

Historical Yield Curve
April 26, 2002 vs. August 8, 2002



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The repercussions of weaker-than-expected economic numbers: Could federal funds rate go even lower?

The strong economic numbers that continued to flow through the end of the second quarter came to a brief halt after the July economic figures were announced, prompting speculation about what the Federal Reserve is thinking about the strength of the economic recovery.

Second quarter Gross Domestic Product (GDP), expected to grow at an annualized rate of 2.1 percent, came in at only 1.1 percent. United States payrolls increased by only 6,000 in July, much less than the 60,000 consensus expectations and less than the 66,000 jobs created in June. Consumer confidence, ISM numbers and other economic indicators were also weaker than expected, which made a lot of brokerage houses rethink their GDP estimates for 2002.

The Federal Reserve attested to uncertainty at its June meeting when it issued a statement saying "the degree of (economic) strengthening remains uncertain." Economic strength has moderated during the second quarter, increasing the market's worry that the uneven growth may signal a tenuous recovery. But optimism prevailed during the July Humphrey-Hawkins testimony, as Fed Chairman Alan Greenspan upwardly revised second-quarter economic growth estimates from 2.5-3 percent to 3-3.75 percent. Greenspan reaffirmed his belief that "fundamentals are in place for a sustained healthy growth," balanced by his concern for the loss of pricing power in the corporate sector, which could eventually lead to weaker profits.

The release of weaker economic numbers in July prompted economists to lower their second-

continued on page 2

Market summary

from page 1

quarter GDP projections from 2.00-3.50 percent to 1.50-2.00 percent. The August Fed policy meeting acknowledged the weakness: "The risks are weighted mainly toward conditions that may generate economic weakness."

This statement was a departure from earlier pronouncements of robust growth. The Fed noted that "prolonged weakness in financial markets and uncertainty in corporate reporting and governance" contributed to the slowdown in aggregate demand. Although the federal funds rate remained at 1.75 percent, the FOMC text heightened investors' expectations of a future rate cut. The yield on the October federal funds futures contract fell to 1.56 percent as traders bet on a 25 bp ease at the September 24 FOMC meeting.

The targeted fed funds rate is currently at 1.75 percent, where it has been since December 2001. Thus, after a year that saw the rate fall from 6.50 to 1.75 in less than 12 months, we have held steady for over seven months. At the beginning of the second quarter many dealers called for a tightening as early as the May FOMC meeting. One dealer reversed its position last week and is now calling for 75 bps in easings by year-end, which would bring the targeted funds rate to 1.00 percent.

Other dealers have jumped on board with ease scenarios of between 25-75 bps. Most worrisome were the weakness in job creation and the drop in consumer confidence. Consumers had been the major drivers of the U.S. economy – consumer spending accounted for almost two-thirds of the country's economic output.

The yield curve has changed consistent with a shift from a tightening to easing bias, e.g., the curve has flattened. The yields on the short end of the curve have experienced a strong rally as the two-year treasuries ended the second quarter at 2.82 percent from a 3.71 percent close in the first quarter while the five-year closed at 4.03 percent from a 4.81 percent level in the first quarter. The notes have lost 89 and 78 bps in the 2- to 5-year area while the 10- and 30-year bonds shed 60 and 29 bps to close at 4.80 percent and 5.51 percent, respectively. The short end of the curve, however, has shown the best per-

formance in Q2 as investors gravitated toward the bond market as a safe haven from stock market turmoil. The intermediate sector showed some improvement as market players implemented extension trades because most were short duration at the end of July. The change in interest rate outlook resulted in a lot of curve-flattener plays compared to the steepeners we saw at the start of the year.

Most investors think bond yields will remain at these low levels if we do not see a recovery either from renewed consumer spending or a pick-up in capital expenditures. Consumer spending, which has been saving the economy from registering negative growth, has started to show signs of weakness. Sales for all retailers in July increased investor concern that spending will fall, weakening the prospects of a rebound. Capital spending was lackluster despite historical low rates. In fact, prices of capital equipment such as computers, machinery and tools indicated falling demand. Corporations could not raise the fresh capital needed to revive business activity. The recent series of corporate scandals has made it hard for companies to borrow money from the street. Corporate bond market issuance has shrunk because investors prefer the safety of government bonds.

The stock market was considered the pariah of all asset classes and the source of pessimism as it registered huge losses based on any kind of performance measure. Investors lost an estimated \$1.5 trillion in wealth which dissipated in the first half of the year after the scandals rocked the market. Negative investor sentiment and unease about corporate governance pulled the DJIA, S&P 500, and the NASDAQ down year-to-date. The Dow lost 15 percent to 8,482, the S&P 500 shed 23 percent to 884 while the NASDAQ registered a 35 percent loss to 1,269 (as of Aug. 13).

The net return on the LGIP during the second quarter of 2002 ranged from 1.874 percent to 1.912 percent. We began the quarter agreeing with the market consensus that the next move by the Fed would be a tightening. However, based on the economic data, now the most likely scenario for the remainder of 2002 seems to be that the funds rate will either stay at 1.75 percent or go lower. Given that, the average life could appropriately be lengthened if investment opportunities arise.

LGIP Advisory Committee

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WSACT Appointment

Currently vacant

EVENTS

Don't miss WFOA 2002

September is quickly approaching and you don't want to miss the Washington Finance Officers Association (WFOA) 2002 conference in Yakima. The class schedule is packed with useful information, including an entire investment track which progresses from investing basics to more advanced topics. There will be debt management, accounting and technology classes, too.

Want to know more? Visit the WFOA web-site at www.wfoa.org/conferen.htm.

Welcome new LGIP participants

Help us in thanking and congratulating new LGIP participants who have become members in the second quarter of 2002:

Cascadia Community College

Also offered by the Office of the State Treasurer. . .

LOCAL Program

Financing solutions for local government equipment and real estate needs.

www.wa.gov/tre/local.htm

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New LGIP Administrator announced at July 19 meeting

Doug Extine introduced Jen Thun as the new LGIP Administrator at the LGIP advisory committee meeting July 19.

Other staff members of the Investment Team attended the meeting and were also introduced. They gave a brief history of their background and their present job duties. (See page 4 for more information on staffing changes.)

A brief update was given on the net LGIP returns for March through June 2002. The LGIP has outperformed its benchmark by about 46 basis points (bp). The targeted fed funds rate has been stable at 1.75 percent. The average life of the pool is currently about 45 days.

A brief history of the events that have transpired to date regarding the Fiscal Year (FY) 2002 LGIP Audit was given. For the past several years, the LGIP has had an outside CPA firm issue an opinion on the LGIP Comprehensive Annual Report (CAFR) based on work conducted by the State Auditor's Office (SAO) as a part of its audit of the LGIP. The contract with the outside CPA firm has expired, so a decision needed to be made about how to proceed with the FY 2002 LGIP Audit.

At the March advisory committee meeting, SAO presented four options to the committee: One was to continue as before, i.e., hire an outside CPA firm. The committee unanimously selected this option. This decision was relayed to SAO along with a request to do the search to select the CPA firm. On May 1, SAO notified OST that due to budget cuts they would have no involvement in the LGIP audit other than what they will do as a line item in the statewide CAFR. With this change in SAO's position, both the options available and the time frame were limited, so the committee decided to go through the RFP process to select a firm to perform the audit.

Wendy Weeks, manager of the Accounting Division, gave a brief overview of the RFP process used to select the CPA firm. The

firms that met the criteria in the RFP were evaluated in several categories and a final recommendation was made to Treasurer Murphy. The CPA firm of Peterson Sullivan PLLC from Seattle was selected. Ray Holmdahl, audit director, and Matt Matson, audit manager, were introduced to committee members. The committee heard a brief history of the firm and an explanation of the process used to perform the audit.

A review of the Fiscal Year 2002 budget was given. The expenses were right on target for the fiscal year. The LGIP average balance for FY 2002 was a record \$5.2 billion. This resulted in more fees being collected than estimated and thus a larger rebate. The estimated rebate is about \$1.39 million.

A brief update was given on the TM\$ project. There is still about a 60 percent use rate by participants. OST is testing allocation of the rebate, which entities will receive at the end of July. Also, work is progressing on streamlining the statement enclosure process. The next phase of TM\$ that will impact the LGIP is the addition of portfolio management/investment accounting. This is now in production and running parallel with SWIMS, the main-frame investment accounting system.

LGIP Holiday Schedule for 2002

The Local Government Investment Pool will be closed on the following days:

Monday	September 2	Labor Day
Monday	October 14	Columbus Day
Monday	November 11	Veteran's Day
Thurs/Fri	November 28-29	Thanksgiving
Wednesday	December 25	Christmas Day

Jen Thun hired as new LGIP Administrator



The Office of the State Treasurer is pleased to welcome **Jen Thun** as the new LGIP Administrator. Jen's first day with the Office of the State Treasurer was July 19.

Jen is a recent graduate of Pacific Lutheran University with a master's degree in business administration. Her studies included finance, managerial accounting, marketing, and communications. Jen brings with her solid analytic and computer skills, as well as a strong customer service ethic.

In her new position, Jen is responsible for administration of more than 550 LGIP accounts. Jen will be speaking on behalf of the LGIP at upcoming statewide conferences. Look for her at the WFOA conference in September.

New faces, old friends

The OST Investment Team has undergone significant staff changes in recent months. I am happy to report we're once again fully staffed.

As you know, **Tracie Kier**, LGIP Administrator since August 2000, went on maternity leave last November. She decided not to return in order to be able to spend more time with her

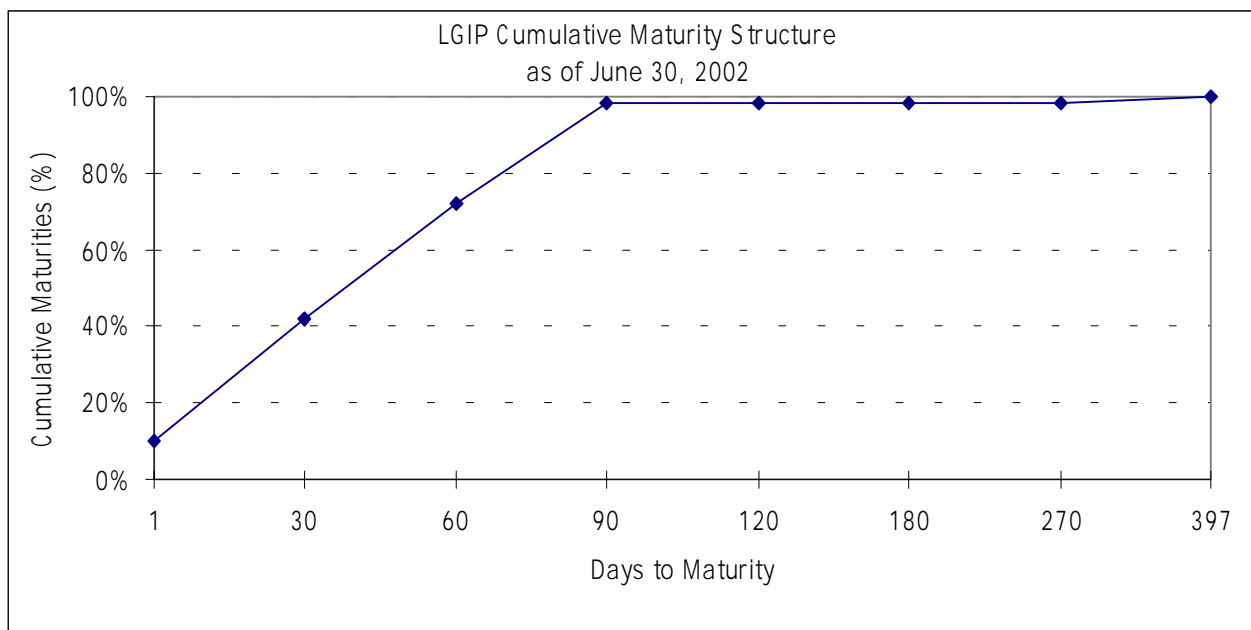
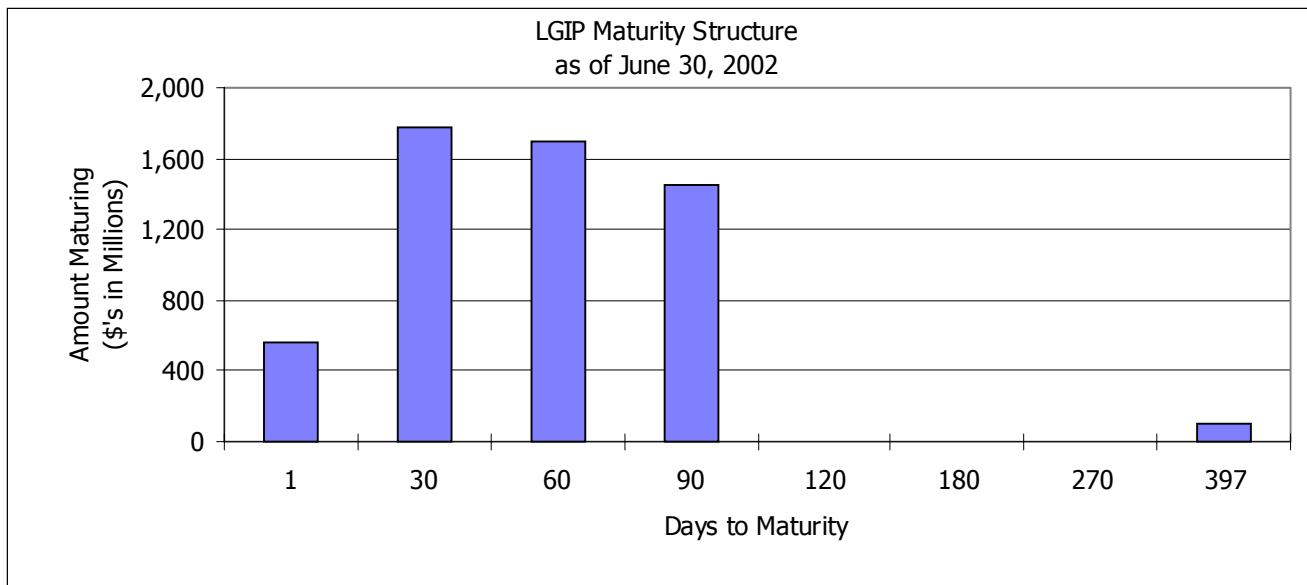
newborn daughter. We miss Tracie but wish her well.

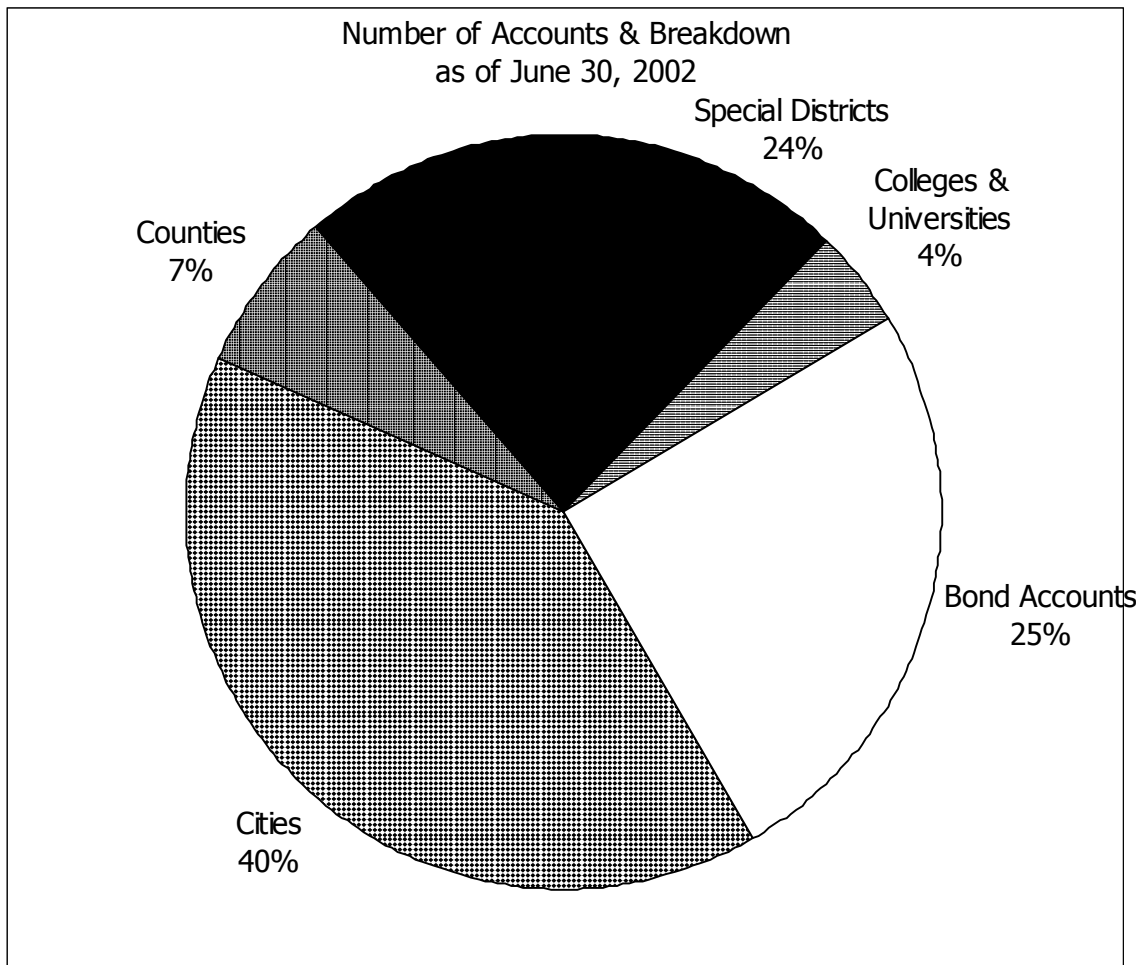
Cristin Wilson has been a valuable member of the Investment Team since 1990. She served as LGIP Administrator until 1997, when she was promoted to LGIP Portfolio Manager. When Cristin went on maternity leave in March, she indicated a desire to return to OST on a part-time basis so she could spend more time with her children. Cristin returned from leave in June and is now working part-time in the Information Systems section helping with implementation of the portfolio management phase of the Treasury Management System (TM\$). We miss Cristin, but we support her decision to work part-time and are glad she could remain at OST.

I am pleased to report the addition of two quality individuals to the OST Investment Team. As you read earlier, Jen Thun is your new LGIP Administrator. **Ferdinand Pascual** was hired in June to manage the state's core portfolio. Ferdie comes to us from Prudential Securities in Seattle, where he was a portfolio manager. Before that, he worked in Hong Kong and Japan, where he received his master's degree. OST is fortunate to have Ferdie as a member of the Investment Team, as he brings solid skills and experience.

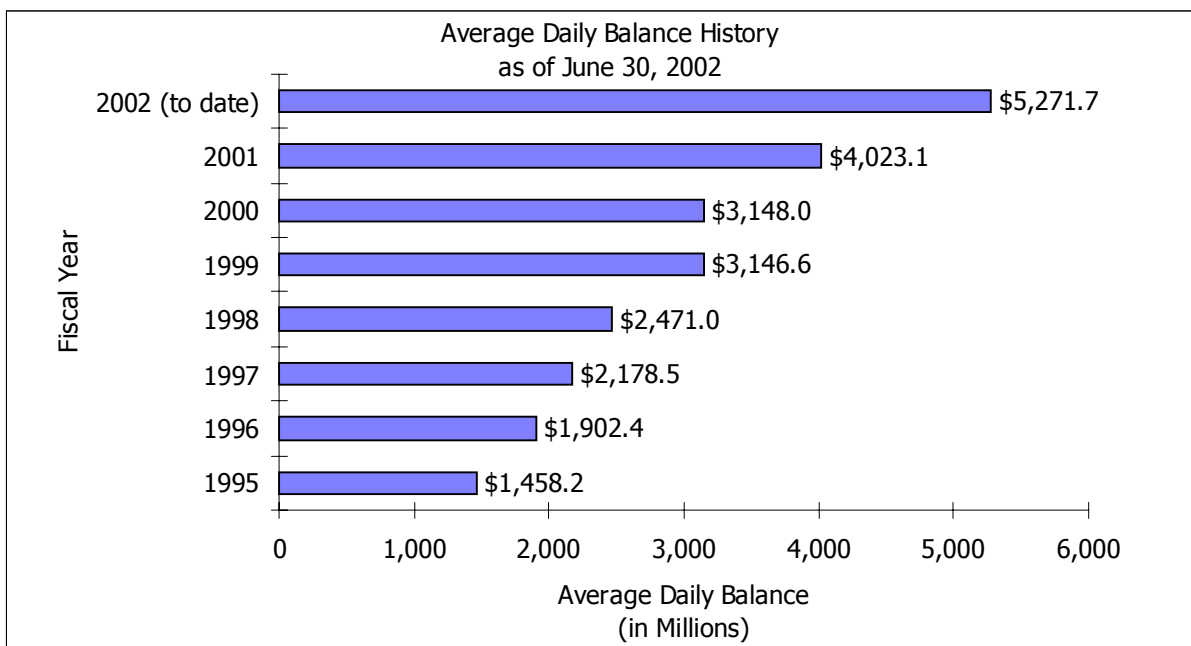
Lisa Hennessy, a name familiar to most of you, will soon become the new LGIP Portfolio Manager. Lisa was the LGIP Administrator from 1997 until 2000 when she was promoted to investment officer. Since November, when Tracie went on maternity leave, Lisa has served as interim LGIP Administrator. Rounding out the Investment Team is **Jill Gravatt**, an investment officer, who has been with the team 15 years. Jill manages the state's liquidity portfolio. I appreciate the work and dedication of Lisa and Jill during this transition time, especially as we brought TM\$ online.

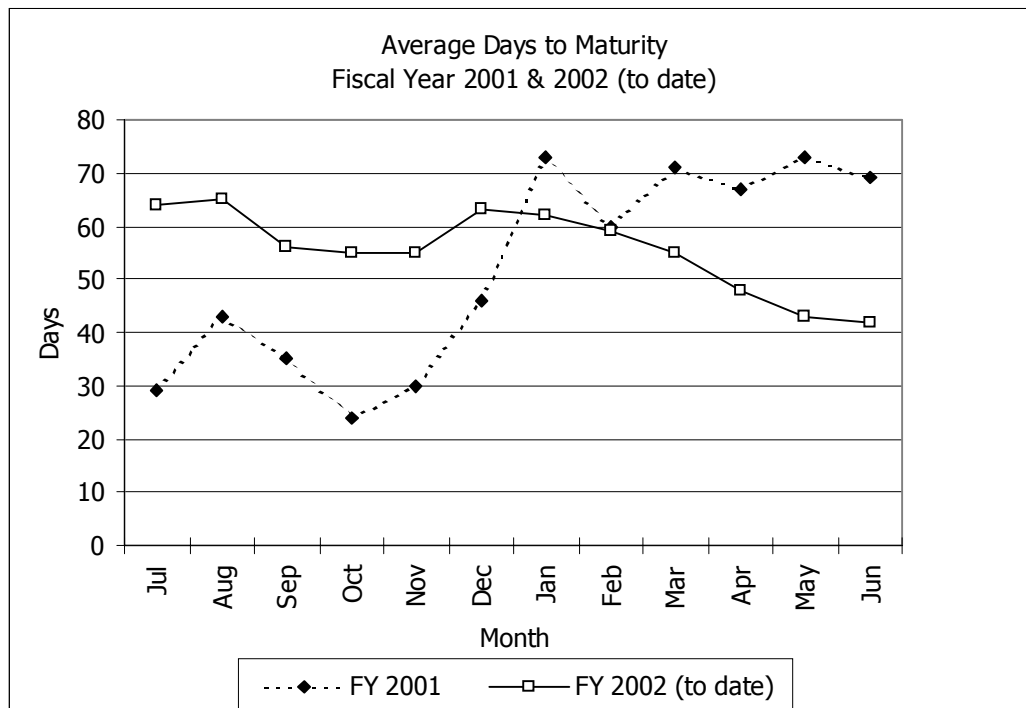
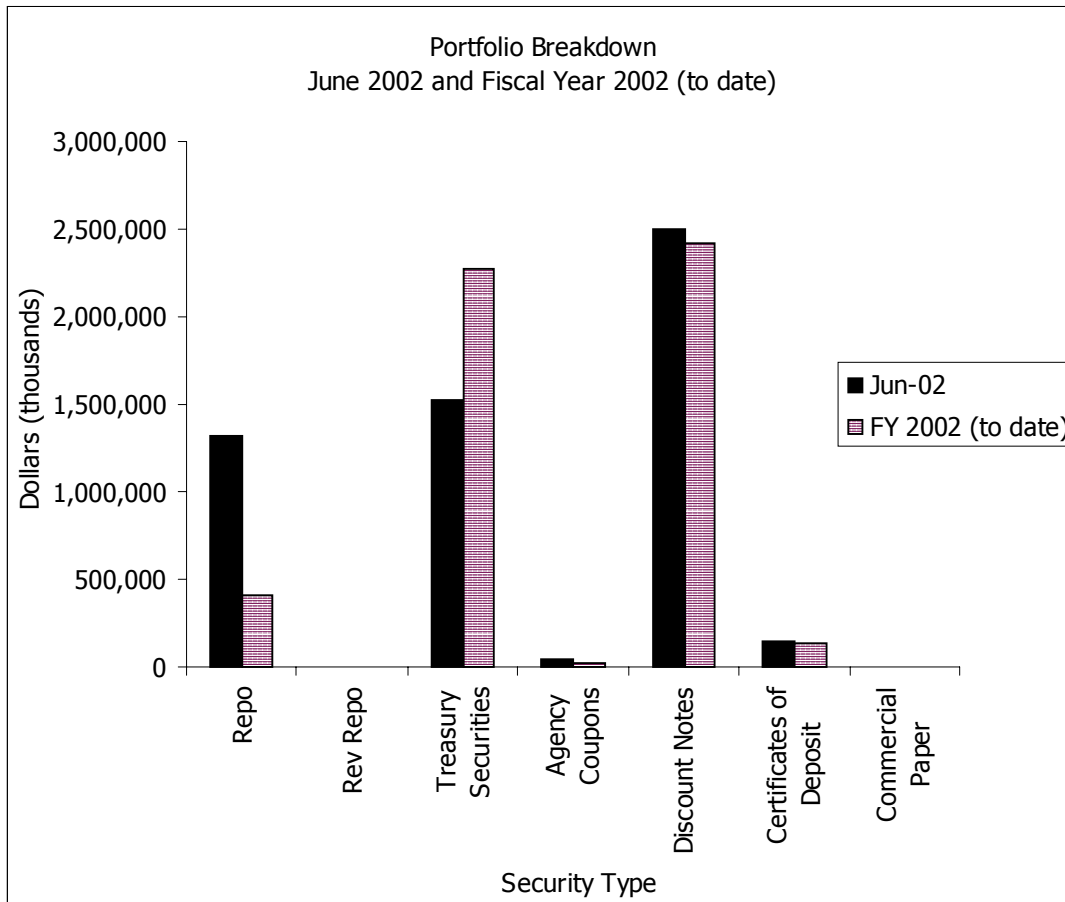
— Doug Extine





Total number of accounts: 555





Washington State Local Government Investment Pool

Position and Compliance Report

as of June 30, 2002

(Settlement Date Basis)

LGIP Portfolio Holdings

	Cost	Percentage of Portfolio
Repurchase Agreements	\$ 458,043,000	8.22
U.S. Treasury Securities	1,697,798,170	30.48
U. S. Agency Bullets	50,909,480	0.91
U.S. Agency Generic Floaters	.....	0.00
U.S. Agency Discount Notes	3,220,080,074	57.80
Certificates of Deposit	144,050,000	2.59
Bankers Acceptances	.....	0.00
Commercial Paper	.....	0.00
Reverse Repos	.....	0.00
* Total Excluding Securities Lending	\$ 5,570,880,724	100.00

Securities Lending Holdings

	Cost
Repurchase Agreements	\$ 683,155,372
Banker's Acceptances	
Commercial paper	
Total Securities Lending	683,155,372

**Total Investments &
Certificates of Deposit** \$ 6,254,036,096

Policy Limitations

*The policy limitations include investment of cash collateral by a securities lending agent calculated as percentages of the portfolio holdings Total Excluding Securities Lending.**

<u>Size Limitations</u>	<u>Holdings</u>	<u>Percentage of Portfolio</u>	<u>Policy Limitations Percentage</u>
Certificates of Deposit	144,050,000	2.59	10%
Bankers Acceptances (BA)	0.00	20%
Commercial Paper (CP)	0.00	25%
Securities With Higher Volatility	0.00	10%
Repos Beyond 30 days	0.00	30%
Aggregate BA & CP Holdings	0.00	35%

Leverage (30% Total Limit)

Securities on Loan (dollars out on loan)	\$ 673,695,343	
Reverse Repos	.....
Total Leverage	\$ 673,695,343	12.09%

Maturity Limitations

	<u>Currently</u>	<u>Policy Limitations</u>
Portfolio Average Life	43 days	90 days
Maximum Maturity	365 days	397 days
Maximum Maturity of Repo	1 days	180 days
Maximum Maturity of Reverse Repo	0 day(s)	90 days
Average Life of Reinvestment of Cash by Lending Agent	1 day(s)	14 days

Policy Limitations (Continued)

Repo Limits Per Dealer

	<u>June 30, 2002</u>	<u>Total Repo Percentage (20% limit)</u>	<u>Term Repo Percentage (10% limit)</u>	<u>Projected Redemptions 7/1/02</u>	<u>Projected Position 7/1/02</u>
ABN AMRO Inc.	\$	0%	0%	.....	.....
Banc of America Securities LLC	140,000,000	3%	0%	140,000,000	.....
Bank of New York	.....	0%	0%	.....	.....
Barclays Capital Markets	.....	0%	0%	.....	.....
Bear Stearns & Co.	87,004,833	2%	0%	87,004,833	.....
CS First Boston	.....	0%	0%	.....	.....
Chase Manhattan	.....	0%	0%	.....	.....
Daiwa Securities America Inc.	.....	0%	0%	.....	.....
Dresdner Securities USA	.....	0%	0%	.....	.....
Goldman Sachs & Co.	300,016,417	5%	0%	300,016,417	.....
Greenwich Capital Markets Inc.	160,000,000	3%	0%	160,000,000	.....
Lehman Brothers Inc.	158,043,000	3%	0%	158,043,000	.....
Merrill Lynch & Co., Inc.	.....	0%	0%	.....	.....
Mizuho Securities USA Inc.	.....	0%	0%	.....	.....
Morgan Stanley	296,134,122	5%	0%	296,134,122	.....
Nesbitt Burns	.....	0%	0%	.....	.....
Nomura Securities Intl Incorporated	.....	0%	0%	.....	.....
Paribas Corporation	.....	0%	0%	.....	.....
Prudential Securities	.....	0%	0%	.....	.....
Salomon-Smith Barney	.....	0%	0%	.....	.....
UBS Warburg LLC	.....	0%	0%	.....	.....
Total	\$ 1,141,198,372			1,141,198,372	.....

Issuer Limitations

** Commercial Paper

<u>Cost</u>	<u>Percentage (5% limit)</u>	<u>Rating (A1/P1 or Better)</u>
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There was no commercial paper holdings as of 6/30/02.

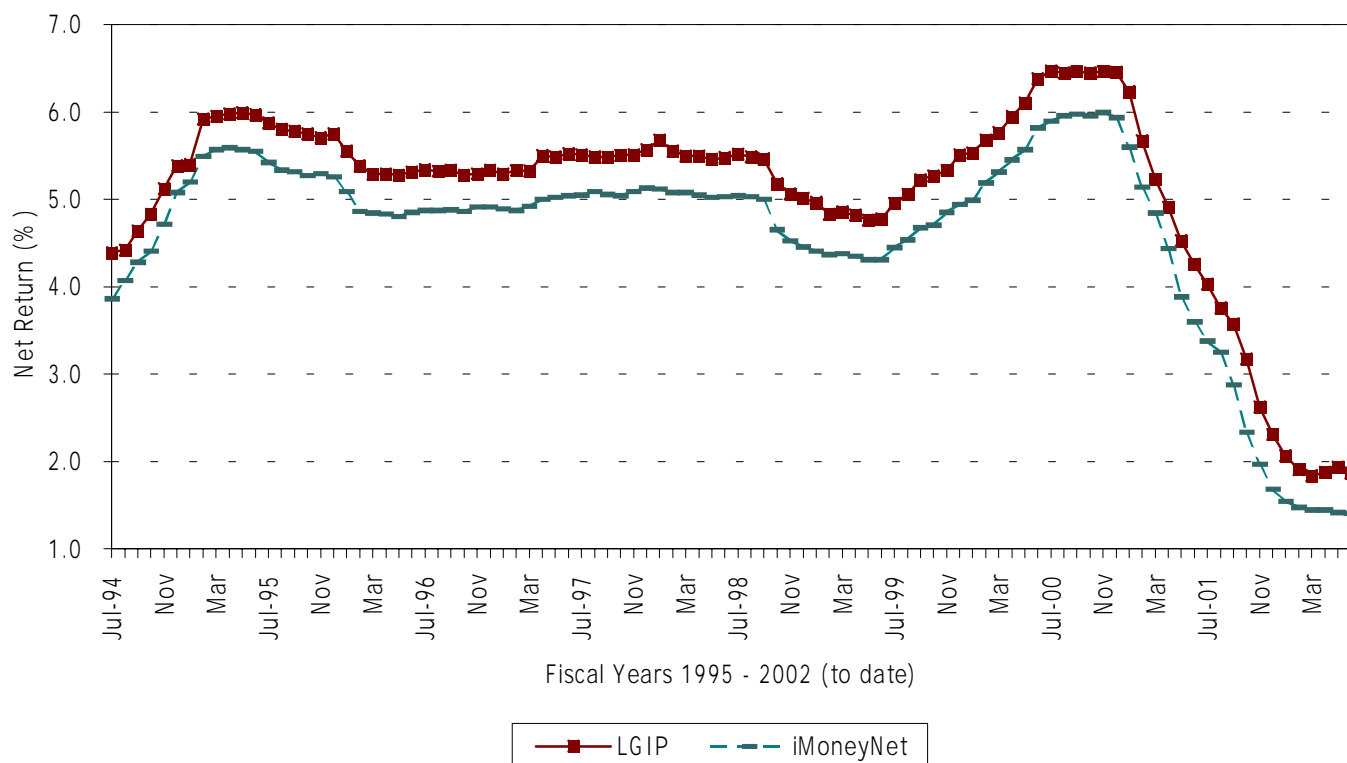
Banker's Acceptances

There was no banker's acceptance holdings as of 6/30/02.

** These are the limitations of the formal Investment policy. However, operating guidelines place limits of 3% per issuer.

LGIP Performance Comparison

**iMoneyNet, Inc., Government Only/Institutional Only
versus
Local Government Investment Pool**



Net Rate of Return Fiscal Years 1995 – 2002 (to date)

Average Net Rate of Return of Government Only/Institutional Only Money Market Funds, Money Market Insight, iMoneyNet, Inc., Westborough, MA.

NOTE: Rates are calculated on a 360-day basis.

The above comparison shows how the LGIP has performed relative to its benchmark since July 1994. This benchmark is the iMoneyNet, Inc., Government Only/Institutional Only Money Market Funds, which is comprised of privately managed money market funds similar in composition and investment guidelines to the LGIP.

The LGIP net rate of return has outperformed its benchmark since July 1994 by an average of 48.0 basis points. This translates into the LGIP earning \$106.78 million over what the average comparable private money fund would have generated.

Local Government Investment Pool

STATEMENT OF NET ASSETS

June 30, 2002

Assets

Investments, at Amortized Cost:	
Repurchase Agreements	458,043,000
U.S. Agency Coupons	50,909,480
U.S. Agency Discount Notes	3,220,080,074
U.S. Treasury Securities	1,697,798,170
Total Excluding Securities Lending and Securities Purchased & Matured But Not Settled	5,426,830,724
Securities Lending Investments, at amortized cost:	
Repurchase Agreements	683,155,372
Total Securities Lending	683,155,372
Total Investments (Settlement Date Basis)	6,109,986,096
Due from Brokers - Securities Purchased But Not Settled, at Amortized Cost:	
U.S. Treasury Securities	50,933,594
Due to Brokers - Securities Matured But Not Settled, at Amortized Cost:	
U.S. Treasury Securities	(100,000,000)
Total Investments (Trade Date Basis)	6,060,919,690
Certificates of Deposit	144,050,000
Cash	(1,999,232)
Interest Receivable	5,752,623
Investment Maturities Pending Receivable	100,000,000
Total Assets	6,308,723,081

Liabilities

Accrued Expenses	663,354
Obligations under Securities Lending Agreement	683,155,372
Investment Trades Pending Payable	50,938,859
Total Liabilities	734,757,585

Net Assets

Participant Net Asset Value, Price per Unit	\$ 5,573,965,496
	\$ 1.00

Total Amortized Cost - Settlement Date Basis \$ 6,254,036,096

QUARTER AT A GLANCE

April 1, 2002 - June 30, 2002

Total investment purchases:	\$ 34,029,042,044
Total investment sales:	\$ 6,155,033,852
Total investment maturities:	\$ 27,562,435,000
Total net income:	\$ 26,603,099
Net of realized gains and losses:	\$ 918,379
Net Portfolio yield (360-day basis):	

April	1.8773%
May	1.9379%
June	1.8740%

Average weighted days to maturity: 42 days

WASHINGTON STATE LOCAL GOVERNMENT INVESTMENT POOL
OFFICE OF THE STATE TREASURER
PO BOX 40200
OLYMPIA WA 98504-0200

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